THE ATTORNEY GENERAL OF TEXAS

AUSTIN 11, TEXAS

JOHN BEN SHEPPERD
ATTORNEY GENERAL

October 2, 1953

Hon. Howard Carney
Secretary of State
Austin, Texas

Opinion No. MS-98

Re: Legality of issuance and continuance of cease and desist order under Texas Securities Act. Application of Art. 600(a) to a company which has collateralized one bond under the provisions of Art. 1524(a).

Dear Mr. Carney:

Your letters of September 24th and 25th present problems growing out of the same circumstances, and will be considered together. The information and questions submitted are as follows:

"Insurance Securities Corporation is organized under the provisions of Article 1303b, Vernon's Annotated Civil Statutes and admits it was in violation of the Securities Act until it qualified with the Banking Commission of Texas on September 8, 1953. This corporation has qualified one bond in the sum of $1,000 with the Banking Commission of Texas. It contends that under the provisions of Article 1524a, Vernon's Annotated Civil Statutes, and in line with your Opinion No. O-2903 (Approved December 16, 1940) it is not now subject to the qualification provisions under an issuer's permit as set out in Section 5, Article 600a, Vernon's Annotated Civil Statutes.

"Your opinion is respectfully requested as to whether a 1303b corporation can avoid the provisions of Article 600a relating to qualification of its other securities by the simple expedient of collateralizing only one bond of a negligible amount with the Banking Commission of Texas."

". . .

"We would like to know further whether or not the file submitted shows violations of the

Texas Securities Act in which there were legal grounds for the issuance of a cease and desist order. If you find that there were legal grounds for the issuance of a cease and desist order, we request a further opinion as to whether or not this office may legally continue the cease and desist order issued by this office on August 20, 1953 against all of the parties indicated until an offer for rescission has been made on all the securities of Insurance Securities Corporation sold previous to Insurance Securities Corporation's compliance with Article 1524a, V.C.S.

"We invite your attention to a letter of solicitation, signed by Mr. R. C. Salley, as President, from Sam Houston Life Insurance Company to its stockholders, in which a solicitation is made to the stockholders of said Sam Houston Life Insurance Company. We also invite your attention to Section 3(o) of Article 600a, V.C.S., which allows an exemption, if such be the case, for only the issuer itself...."

The cease and desist order you referred to became effective August 20, 1953, and was addressed to Sam Houston Underwriters, Inc., Sam Houston Life Insurance Company, Insurance Securities Corporation and the directors, officers, agents, servants and employees of each of them. That order recited the requirements of the Texas Securities Act, found that the Act was being violated and that the further sale of securities issued by Insurance Securities Corporation would tend to work a fraud on the purchaser. The order then required the above named parties to cease and desist from selling or offering those securities for sale until compliance with the Texas Securities Act.

Insurance Securities Corporation was chartered under the provisions of Art. 1303b, V.C.S., and since organization has held a license as a general security dealer under the provisions of Art. 600(a), V.C.S. Sam Houston Life Insurance Company is a domestic insurance company but does not hold a license as a general security dealer. At no time has either of these companies presented to the Secretary of State an application to qualify securities, and an issuer's permit has never been outstanding.

Under date of June 25th, 1953, a letter was written to the stockholders of the Sam Houston Life Insurance Company on the letterhead of that company which reads as follows:

"Dear Stockholder:

"I have been asked by many of our stockholders during the past two years why we did not organize a Fire and Casualty Insurance Company. My answer has been that we first wanted the Sam Houston Life Insurance Company to get going at full steam. This has been accomplished and we anticipate a profitable business from now on.

"We have chartered the Insurance Securities Corporation and are now selling Participating Preferred Stock, Preferred as to Dividends and Liquidation. The present price of the stock is $10.00 per share, which we intend to increase to $12.00 per share in the not too distant future.

"The officers of the Insurance Securities Corporation are:

"R. C. Salley	President and Treasurer
R. R. Bond	Vice President and Assistant Treasurer
A. B. Read	Vice President and Secretary

"I am enclosing some data that is pertinent to the Corporation, also a Subscription Blank, which you can fill in for the number of shares you desire to purchase, retaining one copy for your records. Your check should be made payable to Insurance Securities Corporation, attached to the original Subscription Blank and returned to me in the enclosed self-addressed envelope, marked for my attention.

"I feel sure that you appreciate the opportunity to become a stockholder in this Corporation, and we will appreciate having you. If there is any additional information you desire, please write me.

Sincerely yours,
SAM HOUSTON LIFE INSURANCE COMPANY
/s/ R. C. Salley
R. C. Salley, President

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A copy of that letter was mailed to your office by an investor and was the basis for the cease and desist order of August 20th previously quoted. The cease and desist order is authorized by Sections 24 and 30 of Article 600(a).

Section 3 of Article 600(a) reads in part as follows:

> "Except as hereinafter in this Act specifically provided, the provisions of this Act shall not apply to the sale of any security when made in any of the following transactions...that is to say, the provisions of this Act shall not apply to any sale, offer for sale, solicitation, subscription, dealing in or delivery of any security under any of the following transactions or conditions:
>
> ". . .
>
> "(o) The sale by the issuer itself, of any securities that are issued by ... a company subject to the supervision of the Banking Commissioner under Senate Bill No. 165, 42nd Legislature. . . ." (Should read Chapter 165, which is codified by Vernon as Art. 1524 (a)).

Att'y Gen. Op. 0-2903 (1940) held that a company which filed only an annual report with the Banking Commission was not under the supervision contemplated by the Texas Securities Act and thus such company must comply with the provisions of Article 600(a), V.C.S. At the time the cease and desist order was issued by your office, no attempt had been made by Insurance Securities Corporation to collateralize any notes, bonds, or debentures under Art. 1524(a) and thus, as to that company, Att'y Gen. Op. 0-2903 (1940) would be controlling. Consequently, all sales of securities by that company were made in violation of Art. 600(a).

The action of Sam Houston Life Insurance Company in sending out the previously quoted letter was also in violation of the Texas Securities Act. Section 2(e) of Article 600(a) defines the word "sale" to include a "solicitation of sale" or an "attempt to sell". The letter cannot be construed as anything but a solicitation or attempt to sell. The "Stock Subscription Agreement" which accompanied the letter is, by the same token, a solicitation, but in the interest of brevity is not here set out. Section 3(o) previously quoted is not

available to Sam Houston Life Insurance Company for it did not "issue" the securities. ("Issuer" is defined by Section 2(g) of Article 600(a).

Section 23(g) of Article 600(a) V.C.S., in effect, provides that the securities issued by an insurance company are exempt from registration under Section 5. Att'y Gen. Op. 0-6020; 0-6020A (1944). Sections 12 and 23 specifically provide that the person selling the securities must be registered as a general security dealer. (Sec. 13). Sam Houston Life Insurance Company cannot maintain that its activity came under this exemption since it was not selling its own securities, nor did it have a license as a general security dealer. For the above reasons, this office is of the opinion that the cease and desist order was legally issued.

After your office had issued the cease and desist order, it appears that Insurance Securities Corporation issued a note, bond or debenture of a "negligible amount" and collateralized that bond with the Banking Commission under the provisions of Art. 1524(a). It also appears, from the certificate of issuance filed in your office on September _____, 1953, that Insurance Securities Corporation has sold 8,524 shares of no par stock for a consideration of $85,240.-00.

Your second question is whether or not your office may require that each of these purchasers be given the opportunity to rescind the contract of purchase or affirm their previous decision to purchase. The decisions under the Texas Securities Act are replete with statements that the intent of the Act is to protect the purchasers from sellers of securities. The extent of this protection is very broad for Section 33(a) provides that the contract, when made in violation of the Act, shall be voidable at the election of the purchaser and that the purchaser shall have <u>two years after he learns</u> the sale was made in violation of the Act in which to bring his action for the recovery of the principal and 6% interest. The departmental practice which has been followed by your office (requiring an offer of rescission) would not have the effect of returning the parties to their previous position. It would have the effect, however, of starting the statute of limitations.

In the event violations have occurred, remedies are covered by Sections 30, 33 or 25.

If a company desires to comply with the provisions of the Texas Securities Act and has in the past violated that Act, it would appear that the Secretary of State could require

that the company endeavor, as best it can, to lessen the damages that might accrue against the corporation. Under Section 8, the Secretary of State is required to find that the proposed plan of business of the applicant as well as the methods of issuing and disposing of the securities are fair, just and equitable.

It would be for the Secretary of State to determine if it would be fair, just and equitable to the investing public to permit subsequent purchasers to be liable for the activities of the corporation which were in contravention of the statute before he became a stockholder.

As previously stated, the right to issue a cease and desist order is provided in Sections 24 and 30 of Art. 600(a). The statute specifies the grounds necessary for the issuance of the order. Upon a finding by the Secretary of State that such grounds are no longer present, it would be proper for the order to be removed. It would be for the Secretary of State alone (subject to judicial review) to determine whether such grounds exist,among those grounds is whether the proposed plan of business or whether the methods of issuing and disposing of the securities are fair, just and equitable.

Your third question is whether a company organized under Art. 1303b, V.C.S. may collateralize only one bond "of a negligible amount" with the Banking Commission under the provisions of Art. 1524(a) and thus exempt all of its securities from the operation of the Texas Securities Act.

In the instant case, at the time the cease and desist order was issued on August 20, 1953, no attempt had been made to collateralize any bonds. On the 8th day of September, 1953, the Banking Commission approved the bond sought to be issued by the Insurance Securities Corporation.

Att'y Gen. Op. O-2903 (1940) covered only the situation where no notes, bonds or debentures were issued by the company, and held that the mere filing of an annual report did not relieve the company from complying with the provisions of the Texas Securities Act. In 1948, the identical question you have presented was before this department when San Houston Underwriters, Inc. (which corporation had the same principal officers as Insurance Securities Corporation) sought a declaratory judgment. Before the suit went to trial, the plaintiff dismissed and the Secretary of State and the Banking Commission immediately adopted the view that the collateralization of bonds under Art. 1524(a) made only those bonds exempt from the provisions of the Texas Securities Act.

The Banking Commission is not authorized to examine and pass upon capital structure of the company -- other than the notes, bonds or debentures -- but such power remains exclusively with the Secretary of State. Thus, all other securities would be governed by the provisions of the Texas Securities Act.

It is, of course, elemental, that departmental construction is of assistance to the courts in the interpretation of a statute only where the statute is ambiguous. The fact that your office and the Banking Commission have adopted the same view and held that view for a period in excess of five years would have great weight with the courts since the statute, in our opinion, is ambiguous; then too, exemption statutes must be strictly construed.

The Secretary of State may legally issue an order requiring persons to cease and desist from selling securities in violation of the Texas Securities Act, and may continue such order in full force and effect until the reason for the issuance of the order has been dissipated. Collateralization of a note, bond or debenture under the provisions of Art. 1524(a) does not exempt the sale of other securities by that company from the operation of the Texas Securities Act.

Yours very truly,

JOHN BEN SHEPPERD
Attorney General

By /s/ Elbert M. Morrow
Elbert M. Morrow, Assistant

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